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IN THIS ISSUE

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PLANNED PROFITS

BUSINESS BUDGETING

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Welcome

. . . to the Tenth Annual Conference of the National Society for Business Budgeting.

The Cincinnati Chapter is honored in being your host and will put forth every effort to make your visit both profitable and enjoyable.

It is our sincere hope that your attendance at the Conference will provide you with ideas and inspiration for the years ahead.

H. J. WOEHRMYER
CHAIRMAN
1960 Annual Conference
Harold J. Woehrmyer

Harold J. Woehrmyer

With the above words, Harold J. Woehrmyer opened the Tenth Annual Conference of N.S.B.B. in Cincinnati on May 19, 1960. Those who attended agreed that the Conference was outstanding in every respect. The Conference Committee had worked hard to provide excellent speakers for every session. The meeting rooms and other accommodations were very comfortable, and the luncheons were delicious. Above all, the warmth and sincerity with which the members of the Cincinnati Chapter welcomed their guests was appreciated by all attendees.

Particularly for the benefit of those of you who could not attend the Conference it was decided to print the Conference speeches just as they were delivered rather than editing them into article form. It is hoped that by using this form you will develop a greater feeling of having attended and will be encouraged to attend future conferences. For those of you who attended, reading the exact words of the speeches may help you recall more vividly the Conference scene and the interest afforded each speaker by the audience.

LONG RANGE PLANNING THE KEY TO SUCCESS

Archie R. Boe, Addressing the 10th Annual Conference NSBB, Cincinnati, Ohio.

Mr. Boe is Vice President and Director of the Allstate Insurance Company, Skokie, Illinois.

He was born in Estherville, Iowa, February 27, 1921. Graduated from Drake University in 1941 with BCS in Finance, completed the Executive Training Program and received a Master's Degree in Business Administration from the University of Chicago in 1950.

Mr. Boe joined the Allstate Insurance Companies in June of 1941 as a Trainee. From March of 1942 through November of 1945, he served in the U.S. Navy as a Gunnery Officer on a Destroyer Escort in the South Pacific. After the service, he returned to Allstate, and, with the then Assistant to the President, started the Planning function for the companies.

He became Budget Director in 1948, Director of Planning and Financial Control in 1953, Comptroller in 1955 and is presently Vice President in charge of Planning and Development for Allstate. He was elected a member of the Board of Directors in February 1960.

The Planning and Development Department consists of the Corporate Planning, Pricing, Product Development and International Development Divisions of the company. Mr. Boe is married and has one son, Michael.

I was deeply honored when Mr. Haverkamp invited me to speak before such a distinguished and dedicated group, but I was reluctant to accept the invitation. Certainly it is "carrying coals to Newcastle" for any individual to appear at the annual meeting of the National Society for Business Budgeting to talk about planning. I am sure your organization consists of the capable authorities on this subject. However, I accepted the invitation as it did give me an opportunity to relate my experience and impressions to an astute and interested group, and at the same time, learn of your experiences and progress in using this very valuable management tool.

Before getting into the topic assigned to me this morning, I want to take this opportunity to congratulate the officers and members of the National Society for Business Budgeting for the tremendous contribution they are making to the advancement of modern management techniques. I feel that the subjects of "budgeting" and "planning" have been tossed around by management for a good number of years, but there are relatively few business organizations that have adopted modern systems and techniques of planning the future course of their business. The terms are popular and they are discussed a great deal, but there is a substantial amount of education and understanding to be gained by most managements before planning can gain its proper perspective in today's competitive battle for growth and profits. The objective of your organization which states "that it is an organization in which business executives can increase their knowledge of budget policies and techniques by the exchange of ideas in direct discussion with one another, and by hearing outstanding speakers on budgeting subjects" is an admirable one indeed. All of you can be proud of the contribution you are making to the business world. Mr. Shaw mentioned that this is a growing outfit, and I am sure that not only will your organization grow, but it will gain increased stature and acceptance in all the fields of business endeavor.

I am happy to see so many members of Allstate's management take an active part in this type of organization. Planning is a religion in our company — it's our way of life — and is basically responsible for the success that our company has enjoyed. I might add that our success just didn't happen — it was planned this way.

This morning I want to share with you the experience I have gained in budgets and planning. At the outset I want you to understand that I will try to keep the presentation brief and practical. I want to keep it brief because I know I am speaking to some very capable authorities on the subject of long range planning — and I believe it will be more interesting for everyone if we save some time for questions and discussion at the conclusion of the presentation.

Rather than giving a theoretical discussion, I will attempt to relate my actual experiences. I have had the good fortune of spending my working career since 1946 in business planning — and I have seen our company grow from a centralized organization, with an annual sales volume of 12 million dollars at the end of World War II, to today's large decentralized organization with a complete network of sales and service facilities spread across fifty states and Canada, with a sales volume of over $450 million. Allstate's record is certainly one of the great inspiring accounts of successful business enterprise in America. An effective system of business planning is basically responsible for this success.

THE DECADE AHEAD

As Mr. Shields pointed out in such a clear and interesting fashion earlier this morning, the decade of the sixties — while having its booms, recessions and problems — is predicted to bring tremendous and prosperous growth to our nation. The first quarter year of this decade shows that it will also be a period of intensely challenging competition for the consumer's dollar.

We at Allstate are certainly in agreement with Mr. Shields' predictions. While we may vary a little as far as dollars and percentages of growth, we agree that the productivity and standard of living of our nation will reach undreamed-of proportions.

We are building our plans on the foundation that the economy of the nation, measured in terms of total production of goods and services, will increase from 1959's $485 billion to $770 bill by 1970 — an expansion of almost 60%. Eleven million more people will be working in 1970 than in 1960, and with increased productivity they will add $217 billion of personal income. Some of that income will defray increased taxes, some will be put into savings, leaving $500 billion to be used for the goods and services each of us purchase daily. Today we spend a little over $300 billion so this represents a 67% increase in personal spending.

Our population should increase 18% from 180 million to 213 million people — this is another New York plus a New Jersey plus a Pennsylvania added to our population in a single decade. By 1970 we will have as a market ten million more households than we do today — and eighteen million more private passenger cars. There will be ninety million vehicles traveling our highways in 1970 — almost a 25% increase over the total today. An expanding economy, a growing number of people with higher living standards and a tremendous increase in disposable personal income will bring huge increases in the markets for all goods and services.

But within this period of growth there will be an underlying current of intensifying competition for the consumer's dollar. Within this decade of "prosperous growth and intensely challenging competition" progress will not be automatic. Recognition of opportunity does not alone insure success. Experience tells us that success reverts to those with the vision, the equipment, and the energy to grasp the opportunities offered.

PLANNING FOR THE SIXTIES

The organizations that are to be entered on the roles of those achieving successful growth and profits when the business history of this decade is written will be those who have adopted, and successfully used, a modern, flexible and extensive system of long range planning. There is no doubt about it that competition in this era will intensify — in products, in prices and merchandising techniques. The business concerns which organize to meet these challenges of the sixties and capitalize on the opportunities afforded will be those that will enjoy sound and profitable growth.

Business will not beat a path to your door. All of you will be required to work more aggressively and intensely for your growth and profits. As I said earlier, budgeting and planning are generally an unused tool of management. The principal function of management is to plan ahead and failure to plan ahead will be disastrous in this era of intensified competition. The contention that the difficulty of predicting the future obviates all opportunity for making long range plans is ridiculous. Long range planning is nothing more than the development of plans and programs designed to maximize the return on and utilization of the company assets — both financial and human — in the light of anticipated economic and industry conditions. Plans are developed courses of action aimed at accomplishing a specific purpose. The planning activity is designed to show how the company can increase its sales and profits beyond

normal expectations by identifying areas of opportunity, and by planning ahead on how to best capitalize on them. In addition, planning serves other purposes.

First, careful planning plays an important part in the development of individuals. Decision making is required. The contributions of the organization's many segments must be interrelated and balanced. Key factors used in controlling the business are brought out and are placed in relative importance. Proposed actions are weighed for their effect both on the present conduct of activities and on profit results. This combination of analysis and decision inherent in the planning process builds executive competence.

Secondly, plans are an important means of controlling actions that will be taken by individuals throughout your organization. Plans provide a series of check points staked out in advance. Actual progress may be compared with these milestones to determine the nature and extent of progress made. Determining present conditions does not itself achieve control, but actions ordered and taken on discovery of serious deviations from plan do effect control. Thus, plans are an important means of assuring control over company affairs.

Another important contribution credited to planning is that it provides impetus in achieving company goals. Planning focuses attention and efforts, and initiates actions that give positive and direct progress. Plans have the effect of orders to accomplish a given task, whether they are devised for individuals, for groups, or for the entire company.

PLANS VS. BUDGETS

Perhaps you have noted that I refer to "plans" and "planning" rather than to "budgets" and "budgeting." We at Allstate believe that planning is a broader concept than budgeting. In the minds of many business people the term budget implies a negative thing. It has an unfavorable connotation, and many times it implies limitations or restrictions. For this reason many managers may be reluctant to commit themselves to a budget, but few will object to preparing a plan of operations.

As an example, in your own home, I'm sure that all of you enjoy sitting down with your family and planning a vacation — it's a pleasant experience. How very different, though, if you say to your family "Tonight we're going to work out a budget for our vacation."

All I want to point out is that we are talking this morning about a broader concept. Budgets are a very necessary part of plans. They are developed to control specific performances or expense factors, such as sales budgets and advertising budgets, within the framework of the overall company plans.

PLANNING AT ALLSTATE

So much for the theoretical aspects of long range planning. Now I want to show you how we have adapted this theory into a practical, systematic method of long range and annual planning, from the top to the bottom of our organization. I have mentioned previously that planning is a way of business life in our company. Very frankly, I do not know how we would control the many intricate facets of an insurance company's operations, while achieving substantial growth and satisfactory profits, if we did not have this system installed and our personnel firmly indoctrinated in this type of business philosophy.

First, I will cover our organization.

At Allstate, while the operating functions are decentralized in six zones and thirty branch offices, our long range planning function rests in a central staff at the Home Office.

Our central planning staff is a part of the Planning and Development Department. The Vice President for Planning and Development reports to the President. One Division Director responsible for planning reports to this Vice President.

The Corporate Planning Division is responsible for coordinating all planning within the Company . . . planning designed to maximize our growth and profits. This is our central planning staff and consists of only six people. There are two sections in the division — Economic Development and Long Range Planning. The division also serves as a staff for a Corporate Planning Committee which I will cover later. Using the long range plan as a base, the Corporate Planning Division coordinates the establishment of the annual sales and profit goals — but the detailed scheduling, coordinating and computation of the annual plan is the responsibility of the Controller's Department.

Each of our six zones and thirty branch offices has a staff planning representative called a Regional Controller. As one of its duties this function is responsible for coordinating all planning at the territorial level. So that you do not get the impression that we have 36 full time planning representatives in our thirty-six field offices, it should be pointed out that this staff position is also responsible for the normal controller duties in each office. The branch offices have an aver-

age annual sales volume of over $15 million so you can readily see that their controller duties are extensive.

The interrelationship of these organizational levels is as follows: The Home Office establishes the long range plan and communicates the programs and policies to the Zone. The Zone assigns the plan by territory to its branch offices and follows up to see that the programs and policies are effectively installed.

The branches are responsible for fulfilling the requirements of their assigned portion of the plan within the framework of the policy established. In brief, the Home Office establishes plans, the Zone administers them and the branch executes them.

SIX CARDINAL RULES OF PLANNING

Now I would like to present to you the method used by our company to achieve a successful long range plan. We feel there are six cardinal rules of planning:

1. Top management must be sincerely sold on the benefits of a modern system of long range planning for their organization. Planning is the responsibility of top company management, and they need to give it direction. The finest planning staff in the country cannot develop an effective long range plan unless the top officers of the company believe in the merits of formalized planning and believe that they have the responsibility to look ahead in guiding the destiny of their organization.
2. All members of management must participate in the planning process. It is imperative that each function actively participate in the preparation of the long range plan so that the final plan is enthusiastically supported by each function because it encompasses their own ideas.

   In our company we have established procedures to bring each function into the Corporate Planning activity. Each function — marketing, underwriting, claim, operations, etc. — is responsible for planning their own programs and policies according to detailed steps. The Corporate Planning Division coordinates the separate written plans developed by each of the functional departments. The consolidation of these plans is reviewed by the Corporate Planning Committee and their recommendations sent to the President for approval.
3. Plans must be flexible. A plan should not be allowed to run the company — this is the function of management. All I am saying here is that management should run the company through a plan of operation. A good long range plan is sufficiently flexible to allow management to take action on favorable opportunities as they develop, even though they were not included in the plans. The plan should then be revised to incorporate these new elements. It should be recognized that it is not possible to foresee all technological developments and competitive innovations that will occur in the future. All levels of management should understand that adaption to change should not be frustrated by a rigid plan.
4. Proper organization for planning must be established. Our organizational set-up was described above. There are various places in the organization in which the planning function can be placed — in the Controller's Department or the Treasurer's Department, or elsewhere. However, it should be remembered that the final decision on long range plans is one of the duties of the chief executive of any company — therefore the staff function responsible for long range planning must be so established in the organization as to have ready access to the chief executive.
5. The planning process must be formalized. Planning must be designed to communicate the company goals and objectives throughout the organization . . . direct the company's activities toward these definite goals . . . lay out the problems involved in the future . . . and establish a framework within which team effort by the whole company can be directed toward the achievement of uniform, known goals and expected results. This requires a formal written plan and may encompass more than one volume.
6. Thoroughly review the long range plans annually and revise when necessary. Accurate planning for only one year ahead is difficult in today's complex business world, so it is imperative that plans be reviewed periodically and changed to meet current conditions. A plan that has become obsolete due to unforseen changes, either internally or externally, is no longer a worthwhile management tool.

TEN STEPS LEADING TO THE LONG RANGE PLAN

With these six cardinal rules in mind we be-

lieve you should perform the following ten steps to develop an effective long range plan:

1. Analyze and project all segments of the economy for ten years into the future. This step is necessary to clearly establish the future environment within which you will operate. It will serve as a basis for planning that will be agreed upon by all members of the organization, rather than dealing with the vast amount of contradictory economic data that is published almost daily. It is extremely important that everyone in the organization operate from the same basic data. Our Economic Development section projects the economy of the future in great detail. For example, population projections include such aspects as: Birth rates, death rates, immigration, sex, age groups, marital status, school enrollment, geographical distribution, mobility, households and families.
   From the population projections the labor force is derived, which, in turn, is used to project the economy and such components as: Personal income, consumer spending for goods and services, business spending for investment, housing expenditure, savings, disposable income per capita and per household, government spending, productivity per man hour, and inflation.
   Our studies have resulted in several 150 page books which include not only the figures but also considerable interpretive commentary.

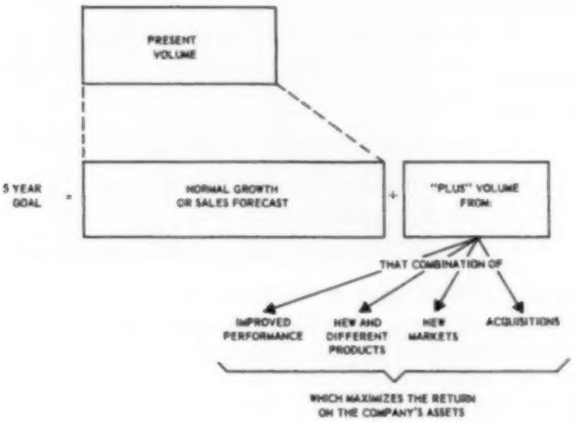
2. *Step Two* — project your market and the anticipated business environment within the framework of the projected economy.
   The economic studies provided the basic information necessary to analyze and project our markets. The population studies were the source of data for the development of families and households which were converted to Allstate market units. These market units provide a measure of the market within which Allstate will operate as a multiple-line insurer. Our analysis of the economy, particularly the consumer expenditure for services, was the basis for our projection of the total insurance market. One of our important insurance lines is that of auto insurance — for that reason we did a comprehensive projection of motor vehicle trends. This gave us an insight into the increase in the number of registered autos. From an analysis of the combination of households, vehicles, total insurance market and inflation we were able to arrive at an amount each family will spend for insurance. This is the future market in which we will participate. In this step it is also necessary to predict the business environment of the feature — what will be the competitive situation in your industry, what social changes will arise that may affect your product, what new technological advances can be expected, what new methods are likely to develop requiring changes in products or procedures, and numerous other aspects of the future business environment. These considerations lead us to

3. *Step Three* — set your organization's goals and objectives within the framework of the anticipated economic conditions and operating environment.

   The first phase of this step is to project the volume of business that may be expected in your present business operations. This takes the form of a somewhat routine statistical projection based upon past performance and recent trends. A thorough analysis of the volume developed by this projection should be made, and you must determine whether this volume will be satisfactory to company management, to the stockholders of the company and, indeed, to yourself.

   If the volume does not meet these requirements you must go on to the second phase of this step which is more complicated and requires that you develop the amount of "plus volume" that will be necessary to reach the goals you desire. This is shown graphically by the diagram. A straight statistical projection for growth puts your sales and profits from the starting point . . . . present volume . . . to the lower box. Effective long range planning permits something more . . . it will show that you must get additional sales and profits either through planned programs for new processes which improve performance; planned programs for new and different products; development of new markets; or acquisitions which stabilize earnings or provide new products or new markets; or a combination of all these factors. To me, this is one of the most important contributions of long range planning. It puts manage-

MAKE UP OF LONG RANGE GOALS



ment on notice — that something additional must be done.

4. *Step Four* — formalize the first three steps and adopt as company policy. All levels must be thoroughly familiar with the data and decisions in the first three steps before they can properly complete their operating plans consistent with the over-all company objectives and goals. The material is presented in a formal book which includes all our decisions, policies, economic data, market information, business environment considerations and volume projections that were developed in the first three steps.
   In our company the decisions required are reviewed by a Corporate Planning Committee which consists of the principal operating vice presidents. Their recommendations are then referred to the President for his approval. The importance of this step should not be overlooked. Having been reviewed by top management and approved by the chief executive, the goals and objectives developed now become policy and will guide the future operation of the company. It is necessary that all functional levels clearly understand the policy decisions so that they can effectively prepare long range plans for their function.
5. *Step Five* — develop a comprehensive marketing plan designed to achieve your sales goals. The marketing plan should be prepared in complete detail and among other things should include sales policies and programs, unit sales, sales outlets and facilities, sales expenses and total sales by product line. I recommend the marketing program be prepared first because I believe that today most companies have solved their productivity problems and that in the sixties the major challenges will be distribution — or sales. It is a fortunate company which does not face a distribution problem today. The marketing plan should be a formal written document that is readily available for follow up to make sure that sales programs and policies are being effectively carried out.
6. *Step Six* — with the marketing plan as a base, all other functions develop their long range plans consistant with the marketing plan and the company's goals and objectives. This step requires close coordination by your staff planners to see that consistency is achieved. The staff should act in an advisory capacity to each functional area aiding them wherever specialized planning knowledge is required.
7. *Step Seven* — consolidate plans of all functions, develop profits and capital requirements, and test for reasonableness. This step is a function of the staff planners. They must be careful to ascertain that the consolidated plan fulfills the broad goals and objectives that were approved in Step 4. Conversion of the long range planning data into financial statements will allow the review of planned operating results on on over-all basis and will establish the future capital requirements of the company. Further analysis of this data will establish the reasonableness of the long range plan. The plan must then be reviewed by the Corporate Planning Committee and sent to the chief executive for approval.
8. *Step Eight* — prepare a formal written long range plan which is launched by the chief executive and which specifies the responsibilities of all functions. After receiving the approval for your plan from the chief executive it should be formalized into a written document in a form that will be readily available for reference in future years. It is extremely important, as an indication of top management's support and of its belief in the policies and programs established in the plan, that the chief executive officer launch the long range plan in your company. Each function-

al department will be afforded "a track to run on" through intelligent use of the long range plan.

9. *Step Nine* — develop annual plan to accomplish the first segment of the long range plan. The long range plan should be used as the over-all guide in developing subsequent annual plans for the company. Annual Plans are made in much the same manner as Long Range Plans, with each functional department participating. In order to achieve your long range goals and objectives it is necessary that annual plans be in strict conformance with the policies and programs established in your long range plan. As a practical matter the long range plan is a series of annual plans, and obviously the accomplishment of your goals must be achieved on a year to year basis.

10. *Step Ten* — the final step in the long range planning process is to review the plan annually, revise it where required, and extend it an additional year. The long range plan to be effective must give full cognizance to current developments — those within the company and those in the market environment. As I mentioned previously, it must not be allowed to become obsolete or it loses its value as a management tool. It is extremely important that regular periodic review and revision take place where indicated.

    When I discussed the importance of flexibility I stressed the reasons for periodic review — and the necessity for management to use the plan as a tool to direct the operation of the company, and not allow the plan to run the company.

SUMMARY

I mentioned previously that in my opinion there are six cardinal rules of planning and I would like to review them briefly with you. The plan must have top management support and we feel it is their duty and responsibility. Second, all members of management must actively participate in the planning process. Third, your plans must be flexible to allow you to capitalize on current opportunities. Fourth, you must establish the proper organizational set-up that will allow you to effectively coordinate the development of long range plans. Fifth, the plan should be formalized and in a form that is available for everyday use. And sixth, the plans should be reviewed and revised annually.

With these cardinal rules in mind I presented to you the ten steps that we believe must be followed in order to develop an effective long range plan. These steps are:

1. Analyze the economy in detail.
2. Project your market and the business environment within which you will be operating.
3. Set your company's goals and objectives.
4. Formalize and communicate your goals to all functions.
5. Develop a comprehensive marketing plan designed to achieve your sales goals.
6. Develop plans of all other functions in your company consistent with your goals and objectives.
7. Consolidate your plans into an over-all long range plan.
8. Have the long range plan launched by your chief executive officer.
9. Develop annual plans in conformance with your long range plans, and
10. Review the plan annually and extend all data one additional year.

In closing I would like to remind you that successful long range planning is dependent upon the attitude of management. Plans can be mere statistical projections by ivory tower statisticians and have no meaning, little acceptance, and make no contribution to the organization — or plans can be living, dynamic programs which the entire organization respects, and develops into reality.

There is nothing mysterious about planning. If you have a good working knowledge and understanding of your operations, you can be proficient at long range planning. Again, it is a matter of attitude — if you believe in planning . . . it is simple. If you don't . . . you will be by-passing one of management's most potent tools for securing growth and profits. I do not believe any of us can afford to overlook this valuable tool in the new era of the sixties which faces us today — an era of prosperous growth combined with intensely challenging competition. With this technique you are enabled to look forward . . . avoid many of the pitfalls that could come your way . . . and capitalize on the opportunities afforded your company.

Gentlemen, may I say again that it was a great honor and privilege to have the opportunity to participate in your annual meeting.

ARE LABOR BOSSES BIGGER THAN UNCLE SAM?

William L. McGrath, Addressing the 10th Annual Conference NSBB, Cincinnati, Ohio.

Mr. McGrath is Chairman of the Board of The Williamson Company of Cincinnati, Ohio, a company employing some 1000 people engaged in the manufacture of heating and cooling equipment and conntainers for jet engines, missiles and delicate electronic instrumentations. He entered the Company in 1920; became Executive Vice President in 1931, President in 1943 and Chairman of the Board in 1959.

He is a Past President of the Cincinnati Chamber of Commerce, the National Society for the Advancement of Management, and the National Warm Air Heating and Air Conditioning Association. He is a Director in a number of Cincinnati's leading industries.

In October 1957, Dr. Norman Vincent Peale presented Mr. McGrath with the annual distinguished service award "for distinguished service to the nation," given by the "Guidepost," a publication which has as one of its objectives the preservation of the American system of free enterprise.

Mr. McGrath has long been a student of labor problems. For four years, 1949 to 1952 inclusive, Mr. McGrath was an industry advisor to the United States Employer Delegate to the Annual June Conference of the International Labor Organization in Geneva, Switzerland. In 1954, and again in 1955, he served as the U.S. Employer Delegate to the Conference, heading the American Employer Delegation. In 1954, he was elected for a three-year period, the U.S.A. Employer Representative on the Governing Body of that organization.

Officers, Directors, Members of the National Society for Business Budgeting, Ladies and Gentlemen: To you my good friend and associate, Marty Perkins, I want to express my deep appreciation for that very glowing introduction you just gave me. I am quite sure you must have been consulting with my secretary. Even though we have been together twenty years, I want to say, and I think you will agree with me, that it's a pretty tough job to take on the assignment of introducing one of your bosses. I want to say to you, Marty, I am mighty proud of you as I know are your associates that I see out there at one of the tables, and the President of our Company, Mr. Murphy, who is just about ready to embark for Ireland, sitting up there in the balcony. Under the circumstances I can assure you that it is a most pleasant experience to be here today.

When Larry Haverkamp called me up many months ago about this assignment and I learned just who I was going to speak to, the budgeteers and comptrollers of America, it didn't take me very long to make a decision because, in my book, I am today talking to the most important people in American business. At least I can say to you that so far as The Williamson Company is concerned, there is no group of men in our business to whom the management of the Company listens to more carefully and with greater consideration than those who comprise the offices of our comptroller and the members of our budgeting office.

LABOR BOSSES AND BUDGETS

As you read your program you may have said to yourself "What in the world has the subject of 'Are Labor Bosses Bigger Than Uncle Sam?' got to do with cost control and bugeting?" and yet I am sure there is no one here in this room so naive as not to realize the influence and impact that the Labor Bosses have had upon the costs of every item entering into your budget projections.

Furthermore, unless some means can be found to control the violent acts and unreasonable demands of the Labor Bosses, management will

continue to lose control over its costs. Today we can see the effects that their unreasonable increases in wages are having upon domestic and foreign competition.

So that gets me down to my subject which I am going to repeat again, "Are Labor Bosses Bigger Than Uncle Sam?" Personally I believe that no individual or group should be bigger than the Government of the United States, but I will leave it up to your judgment after you hear my thoughts on this subject, as to whether or not the Government of the United States is still the Government of the United States as we would like to see it and as it should protect all of the people under law. So here we go — — —

THE POWERFUL INFLUENCE OF LABOR

Organized Labor emerged from the 1958 election as without question the most powerful influence in the United States.

In Washington who has been putting up the fine new buildings with the plush offices? Who has had more political influence, locally and nationally, than anyone else? Who, by one word from headquarters, can shut down the steel industry as well as this country's transportation and communication system over night and paralyze the nation? The Bosses of Big Labor.

The dominant position of the Labor Bosses is not just an accident. How did it come about? What caused it? The fact is that there are a great many things about labor unions that the general public just doesn't understand. I'm thinking, for example, about the housewife or the dentist or the teacher or the minister, who is a kindly person, who wants to be reasonably liberal and modern, who doesn't know much about corporations but rather distrusts them, and who supports pro-labor candidates upon the assumption that it will "help the working man."

HISTORICAL BACKGROUND

The Great Depression was often unjustifiably blamed on the bankers and the heads of corporations. So the pendulum swung over on the anti-employer side and we got the Wagner Act in 1935. I don't think a bit of history will hurt. The Wagner Act not only provided a green light for unionization, but it set up a Labor Board which promptly gave itself the function of fostering unionization wherever possible. The Board frequently used its power not to provide its employees with freedom of choice as to whether or not they wanted to bargain collectively, but to push employees into unions, regardless of their wishes. It did this by its manner of determining bargaining units, its framing of the ballots and other means. And it discriminated against small independent unions in favor of the big national federations.

But now the political implications of the situation were becoming apparent. What happened was a tie-in between politics and big Labor. There was money to be made in the labor business, a lot of money; there was power too, political and economic power. So the professionals, the career men, took over. The Labor Board played into their hands. That closes the first chapter of the Wagner Act.

Now the second chapter. Twelve years later, in 1947, the Taft-Hartley Act amended the Wagner Act. It was designed to bring about equality between employers and employees. The answer is that while in theory the Taft-Hartley Law was supposed to put employers and employees upon an equal basis, it merely restrained some of the extreme practices of organized labor, while by its silence sanctioning things that, for anyone else, would be outside the law.

LABOR'S PRIVILEGES AND IMMUNITIES

The fact is that for some years and in most of our states; labor unions have enjoyed certain legal privileges and immunities. They could do things that other people could not do without being jailed, fined or sued, either because the law permitted it or because the law could not be enforced as a practical reality. It is these immunities and privileges, rather than the universal support of the working man, upon which the labor bosses have built their power. You can feel what has happened in your costs today.

Let's look at some of these privileges and immunities. It's a general rule of law that repeated and continued trespasses upon anothers land may be stopped by a court injunction. But, as to labor, picketing is not trespassing. It is "free speech." If it was done by any other group, the picketeer could be arrested. But not a union man. He is in most states almost immune.

It is true, as I said before, that a court can issue an injunction against mass picketing of the military type, designed to prevent ingress to or egress from the plant. But this is not as simple as it sounds. You have to have evidence to pre-

sent to the court, a judge with political courage, and a police force willing to enforce the injunction. Now I thank God that in Cincinnati we have a great police force. We have law and order. We have a great Court, but many cities in the United States are not as fortunate as we are here in Cincinnati. The fact is that picket lines, plenty of them, are still operated on the basis of physical violence.

You read it in the papers, as all of us do, accounts of union interference with traffic, assaults on drivers, overturning of trucks, breaking of windows, paint throwing, blackjacking, telephone intimidation, destruction of property, and so on. These tactics are frequently the standard tools of organized labor. Anyone else might be jailed for them. But the unions are immune — either because it has become customary not to enforce the law in their case or because they are literally unreachable under law due to the nature of their organization.

We have anti-trust laws in this country which are supposed to prohibit monopoly. The AFL-CIO is certainly monopolistic in that it has garnered for itself over 75% of the nation's membership in labor unions. But unions are not incorporated and, except in cases of "conspiracy" with non-union groups, they are specifically immune from our anti-trust laws. A corporation is liable for acts committed by its employees as its agents. But it seems that when a worker on strike bombs a plant, the Norris-LaGuardia Act makes it extremely difficult to prove that he is doing so as an agent of the union. It is just a whim of his own. So the union bosses cannot be arrested for it, nor can the union be sued for it. This is a unique immunity.

Now let's take the question of contracts. I don't suppose you think much about labor contracts. To you they may be just something that, according to the papers, are "arrived at" by the employer and the union. Well, to set the record straight, in the field of labor, a contract is an agreement that has to be lived up to by the employer, but for all practical purposes does not have to be lived up to by the union, either because of immunities under the law or because political or other realities make enforcements difficult or improbable.

This same practical impossibility of collecting damages from a union has applied to cases of picketing designed to destroy the reputation of a business or to boycotting. Both these devices have been used by unions as persuaders in their organizing activities. A public utility is liable for damages for failure to provide service. Now suppose such failure is caused by a strike. In such case the company is still liable, but the union, which stops the service, may not be in some states.

Now let me go into various forms of what might be called economic blackmail. A union man would walk in to an employer and say, "Sign up, Brother; otherwise no trucks will deliver a single truckload of materials into your plant or take any of your products out of your plant." What could the employer do? Of course, there were administrative remedies open to him, but often, as a practical matter, the employer found that he either had to sign up or risk being put out of business. So he signed — thereby forcing his own employees into the union. Those are the tactics so often used by the Teamsters' Union.

Now let's take collusion in the fixing of prices. The Barbers' Union, for example, sets the price of haircuts. If three companies in a certain product field got together and agreed on prices, they would be prosecuted under our anti-trust laws, but not the Barbers' Union. Price-fixing, combinations in restraint of trade and similar practices that are considered sinful for corporations, are quite all right for the labor unions.

The Corrupt Practices Act. as amended in 1947, states that it is unlawful for any corporation or any labor organization to make a contribution or expenditure in connection with any election at which a senator or representative to Congress is to be voted for. So corporations cannot make campaign contributions. But what about the unions? In the 1958 election they made contributions to the election campaign of 121 candidates for the House and 30 candidates for the Senate. You may be interested in where I got that information. It appears on Page 1406 of the November 7, 1958 issue of the Congressional Quarterly. It is entitled, "Recipients of Labor Money in 1958 election." An introductory paragraph states: "This listing shows Congressional candidates who received campaign money from any or all AFL-CIO affiliates, the Brotherhood of Railroad Trainmen, or the Railway Labor Executives Association."

How do the unions become immune from the Corrupt Practices Act? As I understand it, the Unions claim they do not make direct contributions. Members are asked to donate money to

special political education committees and the committee makes the contributions.

Now let us go back to some of the things for which, in theory, a union may be sued, such as violation of contract, improper picketing, boycott practices, and so forth. One of the reasons why local law enforcement officers and the courts hesitate to take action in this field is that for them the expedient way out of such a situation was to pass the buck to the National Labor Relations Board. The tendency of the courts was, more and more, to say that the Labor Board had jurisdiction, even though physical violence, destruction of property, persistent trespassing, intimidation and so forth, are not economic issues properly involved in collective bargaining.

VIOLENCE IN LABOR RELATIONS

Just to show you what all this means — this gets it back home — suppose Mrs. Jones lived in an apartment house that employed a garage man, a yard man and a janitor. Let's assume that these three organized as a local of the Apartment Employees' Union, and demanded higher pay, and let's say the owner of the apartment told them he wouldn't pay it and they went out on strike and then operated in the same manner as many unions do when they strike in an industrial plant. What could Mrs. Jones expect them to do? Bring in imported pickets and picket the apartment, carrying big signs, telling the neighbors that the apartment owner was a stinker. The pickets would refuse to let anyone but Mrs. Jones and her family into her apartment. She couldn't have a cleaning woman. She couldn't call in a television repair man. The pickets would stop deliveries of milk and groceries. They would refuse to let a plumber or a furnace man enter the apartment. They would knock out delivery men if they tried to get through the picket line. They would smash windows, trample shrubbery, tip over cars, bomb the entrance. They would call up the owner and ask him if he wanted something to happen to his children.

Mrs. Jones or the owner would call the police. But the police probably wouldn't do anything. They'd say they were there to preserve order. They probably wouldn't let any delivery men or repair men in, or visitors or friends; because, as they said, they wanted to prevent violence.

The apartment owner might try the courts. He might try to get an injunction against the strikers, but to do that, he would first have to have evidence of violence or property destruction. If the apartment owner tried to get a photographer out to take pictures, the strikers would break his camera. The easiest way for the apartment owner to get evidence would be to get himself hit on the head with a club. But then he wouldn't be in court to testify — he'd be in the hospital instead.

Believe it or not, I am not exaggerating. I have simply applied to a residential apartment what happens all too often in industrial disputes.

RECENT LEGISLATION — THE LANDRUM - GRIFFIN BILL

The Labor-Management Reporting and Disclosure Act of 1959 generally referred to as the "Landrum-Griffin Bill" which was enacted last fall — the third major step in remedial legislation — does contain some important and constructive provisions as to the internal conduct of unions. It clarifies and protects the rights of individual union members in relationship to the union. But as to the legal privileges and immunities that have given labor bosses their unique power, what does this new bill do? Only these things — and you see I have taken you so far through Bill One, the Wagner Act; Bill Number Two, the Taft-Hartley Bill, and progress was being made, and more progress has been made in the Landrum-Griffin Act than people generally realize, but this is what this Landrum-Griffin Bill does. This is where the law moves in and finally catches up with a few of the evil acts of men, just as you men as budgeteers and comptrollers finally catch up with some of the bad practices that are being indulged in in the average business. This is what the Landrum-Griffin Bill does: It places certain limitations upon organizational picketing. It outlaws certain types of secondary boycotts. It provides that local courts may handle local cases that the Labor Board considers too small to bother with. That is important. And for reasons not explained, it grants certain exemptions and privileges to the building trades unions, the effect of which will be to legalize and encourage compulsory unionism in the building trades.

NEEDED LEGISLATION

The fact is, therefore, that in the main the broad immunities and privileges of organized labor remain unchanged and, unless something is done about them, there will still be only trouble ahead. What should be done? I am not a lawyer and would not venture to suggest specific remedies. But as a layman, it seems to me that what is

needed is simply to put labor unions on the same basis as everybody else. Here are three measures that might be taken:

First, make unions subject to our anti-trust laws, just as corporations are subject to them. Now when the anti-trust laws were designed in the early nineteen hundreds, they said, "No, we must respect unions because they are weak. They are not financially strong. We must encourage them." So they put business in a strait jacket, but specifically made unions exempt.

Second, make unions subject to the same rules as corporations with respect to contributions to Congressional political campaigns.

Third, subject the unions and their members, like any other citizen, to the enforcement of existing state and local laws with respect to lawlessness and violence.

To do all this will require courage in public office. So may I urge you to lend your support to candidates whom you know will not be afraid to stand up against the labor bosses. It will take real fortitude, believe me. We have a Congressman, Gordon Scherer, from this district that isn't afraid to speak up. He is regarded as one of the two most courageous Congressmen in Congress and he is backed up by most of the people of Cincinnati.

Now following the passage of the Landrum-Griffin Bill, James B. Carey, President of the International Union of Electrical, Radio and Machine Workers, sent a letter to all members of Congress who voted for the bill. Let me quote the last two paragraphs of that letter.

"You may believe that you are safe in such actions because organized labor is relatively weak in your District and cannot call you to account for the damage you have sought to do to it. You may be right — at the moment.

"We wish to assure you, however, that we shall do all in our power to prove to the working men and women in your District that you have cast your lot against them and they should therefore take appropriate action at the ballot box."

Well, there you have it. Who is going to run the country?

In his book entitled "Labor Union Monopoly," Donald R. Richberg says: "In the last twenty years the political power of organized labor has grown steadily with its vast increase of economic power. Ambitious labor union officials, both the best and the worst, have developed Napoleonic concepts of making the political power of the Government subservient to Big Labor. They seek to control government immediately as their ally, and eventually as their servant."

THE TWELVE YEAR CYCLE

By a strange coincidence of timing the three major changes in labor law legislation have occurred in a twelve year cycle; namely, 1935, 1947 and 1959. Now to me there is a strange significance there that I think is important.

The Wagner Act was passed in 1935. Following its enactment there was a period of turmoil and trouble, with labor abusing its new-found power. There was a growing feeling that something had to be done.

In 1947, twelve years later, something was done. Congress passed the Taft-Hartley Law. As Bob Taft said to me at that time, "The law usually catches up with the evil acts of men." And just remember that. As long as you have Government under Law, the law will catch up with the evil acts of men. And it's catching up. The Taft-Hartley Act corrected, to some degree, the excesses of the Wagner Act — but again, as time went on, more trouble began to brew, and again there was the feeling that something would have to be done.

In 1959, again twelve years later, something was done. Congress passed the Labor-Management Reporting and Disclosure Act, the Landrum-Griffin Act.

Is this enough? I do not think by any means that it is. As I have pointed out today, there are basic problems that still remain to be solved. Let us hope that we will not have to wait another twelve years before the cycle comes full, but that long before then we may witness the passage of the fourth labor law — one that will really be corrective and make unions assume the same responsibilities under the law as employers are compelled to do.

HOPE FOR THE FUTURE

Gentlemen, the situation is not hopeless. We may not be able to speed the turning of the wheel, but it will turn and, after all, what is twelve years in the lives of men and records of history.

Is Labor going to be bigger than Uncle Sam? I don't think so. The Law usually and finally catches up with the evil acts of men.

Thanks a lot. I do hope you have a wonderfulful meeting. It has been a great privilege to be here talking to you.

Planning and Financing Long Range Capital Expenditures . . . .

Wm. H. Zimmer, Addressing the 10th Annual Conference NSBB, Cincinnati, Ohio.

Mr. Zimmer is Executive Vice President and Director of The Cincinnati Gas & Electric Company, Cincinnati, Ohio.

He is a graduate of the Cincinnati schools and the University of Cincinnati, a municipally owned institution. His entire business career has been with The Cincinnati Gas & Electric Company and from 1939 has been Assistant Treasurer, Assistant Secretary, Treasurer, Director, Vice President, Executive Vice President, Member of Executive Committee and Officer of Subsidiary Companies. Since 1952 he has been Assistant Secretary, Assistant Treasurer of the Ohio Valley Electric Corporation and Indiana-Kentucky Electric Corporation.

Mr. Zimmer is a Past President of the Cincinnati Control of the Controllers Institute of America, and past Chairman of the National Committee on Securities and Exchange Commission Regulations of the Controllers Institute of America. He is past Chairman Edison Electric Institute National Accounting Committee. Chairman of the Investor Relations Committee of the Edison Electric Institute, and also a member of the Committee on Financial Management and the Management Committee of the General Management Section of the American Gas Association.

Ladies & Gentlemen:

It is an honor and a pleasure to address this Tenth Annual Conference of your Society. I am happy that you have chosen our fair city for your National Conference and hope that you are thoroughly enjoying the facilities that Cincinnati and its metropolitan area have to offer.

Although I will discuss the planning and financing of long-range capital expenditures, which I will particularly relate to my experience in the utility business, it is my understanding that almost all of you are associated with businesses other than public utilities. Therefore, in order to provide some background to our planning problems, I'd like to tell you something about the particular characteristics of the utility business.

CHARACTERISTICS OF PUBLIC UTILITIES

First, we sell a service rather than a physical product. To provide this service requires a tremendous investment in plant, which in relation to sales, turns over very slowly. For example, during 1959, our plant to sales turnover was once in every three year. This compares to approximately eight times in one year for The Kroeger Company, a food merchandising firm, and two times in one year for General Motors Corporation, as an example of a manufacturing concern. While most merchandising and manufacturing enterprises sell their inventory, a utility company more or less sells it plant in the form of gas, electricity, communication or transportation service.

Secondly, gas and electric services as repre-

sentatives of utility service, must be supplied to anyone and everyone who applies for them, and they must be instantly available at the flick of a switch or turning of a knob, twenty-four hours a day, every day of the year. Dependable and adequate service has become so vital to American urban life that you can imagine what havoc would be caused by an interruption in that service. The breakdown in New York last summer, when a large section of Manhattan was without light, air conditioning, refrigeration, or elevators, for several hours is a good example of the utter turmoil of an interruption of electric service.

Because of this mandate to have adequate service available at all times to serve our present customers and our future customers, a great deal of careful planning must be done to assure that our plant facilities, generating, transmission and distribution, are sufficient to meet the need. However, although we must have reserve generating capacity to meet the requirements of prudent engineering practice, we must be careful not to overbuild our plant to the extent where we would have plant unnecessarily idle, and hence a burden of over investment on our customers, or our stockholders.

Because of the large investment and slow plant turnover, it obviously would be uneconomical to duplicate the facilities of a gas, electric or telephone company. To support two or more competing systems in the same service area, not only would result in higher service rates for customers, but it also would be unfeasible from a physical standpoint.

To avoid this confusion, utility companies are given the exclusive right to provide their service in a specific area. Because of the lack of direct competition, utility companies are regulated as to quality of service, accounting, financing, and, most important, as to the price or rates they can charge, by governmental commissions, which take the place of competition. The commissions are responsible for requiring the utilities to render service of a quality, and to charge prices, at a level that would prevail under a competitive situation.

Thus, while any other type of enterprise can raise or lower its prices as competitive forces dictate, the utility company must obtain the approval of a regulatory agency before it can change its prices. Basically, utility rates are set at a level which will produce revenues equal to all operating expenses, including depreciation and taxes, plus a reasonable return on the investment in facilities used to render the service.

COMPETITION

While utilities may have the exclusive right to sell their service in their area, this does not mean that they are completely free from competition. For example, the gas business must compete directly with other forms of fuel, such as coal or oil, which in the area of industrial sales is really stiff competition. The electric utility industry, however, has the toughest competition; it must compete with Federal Government-owned public power and other governmental power agencies, which are largely tax-exempt.

There has been a tremendous growth since 1933 in public power, from 6 to 24 percent of the total output of electrical energy, and Federally produced power alone rose from less than half of one percent to 17 percent. This expansion has not taken place because of any real economy in the cost of producing public power. It has taken place because government has gone into competition with its own citizens, not only by undercutting the rates established by the public utility commissions as fairly representing the cost of producing power (including a fair share of the aggregate tax burden), but also by actively discriminating against private concerns in the marketing of power generated by Federally owned and operated installations.

PUBLIC POWER

The first essential to a clear understanding of this public power question is a firm grasp of the basic truth that the cost of power to the people as a whole is the cost of producing it, not the rates charged for it. Herein lies the chief source of the confusion that exists regarding the comparative costs of private and public power. Private companies and the investors in their securities pay heavy taxes, and their rates must include reimbursement for these taxes. Governmental agencies are largely exempt from taxation. Furthermore, these agencies receive from the Federal government the benefit of low interest rates which are far below the rates on the open market and considerably below the rates which the government must itself pay to borrow money. The resulting savings in direct tax costs and in financing costs enable these agencies to charge much lower rates than private companies and still show no deficit on their books.

This creates the illusion that public power is cheaper than private power. The truth is that it is cheaper to the consumer, but not to the people as a whole. It is cheaper to the consumer only

(Continued on Page 20)

SEMINAR SPEAKERS

Jack L. Watson

Ed. W. Buge

Harry P. Kelley

Kurt H. Shaffer

1960 Annu

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Luncheon With the Wives

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Our Ladies At Lunch

nual Conference

The Dallas Delegation Sells the 1961 Annual Conference

Art Moor, National President and Bill Campbell, 1961 Conference General Chairman

Glenn Massman, Luncheon Speaker ask "Its Your Future — What About It?"

Hal Mason Gets "Pinned"

Planning and Financing Long Range . . .

(Continued from Page 17)

because he receives the benefit of tax exemptions and other forms of subsidy, which are not granted to the consumer of privately produced power. Since government must have its revenue, the taxes, not paid by consumers of public power, must be paid by others, which means that the others are, in effect, subsidizing public power consumers.

The result of this discrimination is a gravitation of large power consuming industries into areas of low power rates, that is, areas served by public power. This widens the scope of the discrimination, and at the same time, inhibits the growth of other areas, and aggravates the tax burden they must pay for the benefit of the favored regions. It tends further to create a perpeutal power shortage in the subsidized areas, and gives rise to a demand for even greater expansion of the public power facilities. In this way, the growth of public power tends to snowball far beyond the original intent when the projects were set up.

The drift toward public power has been speeded by a number of legislative and administrative policies, epsecially since the Federal Government entered the power business on a large scale. For example, the Government has undertaken to "firm" its power supply by constructing steam plants to offset the fluctuations of water power. It has introduced the "captive" clause into power contracts, requiring customers to use Federal power exclusively. It has forced private companies to transmit Federal power to governmental agencies by threatening to duplicate their facilities. It has encouraged the organization of local governmental bodies to enter the power business, and has given financial aid to such agencies to duplicate existing equipment.

Most of the devices by which this discrimination has been practiced have been adopted under the authority of the so-called preference clause, a provision included in almost all legislation dealing with Federal power projects, which requires preferential treatment to government agencies in the sale of Federally produced power.

To my mind, the history of public power emphatically indicates that it would be difficult to formulate a program representing more aggressive encroachment by the Federal Government in the business field.

I have digressed at some length on public power competition because it has become an important consideration to electric utility companies, and is indeed, one of the special characteristics of the utiltiy business. Let's hope that the future does not hold a similar development for other major industries.

FINANCIAL CHARACTERISTICS

Another characteristic of our business is relative stability of income. Gas, electric and other utility services are a necessity to our people, and although they consume a relatively small portion of the budget of the average family, they provide a great amount of service for their cost.

The combination of a large investment and relatively stable income encourages utility companies to finance a large portion of their capital requirements in the form of debt securities. The cost of this type of capital ordinarily is lower than equity capital, and stable earnings minimize the risk of the fixed charges. The proportion of debt in the capital structure of the typical public utility is at least fifty percent.

The last of the special characteristics of our industry that I will mention is the matter of a high dividend to earning ratio. The average utility pays dividends equal to about 70 to 75 percent of its common stock earnings. Therefore, the retained earnings are very inadequate as a source of capital for the required large expansion programs. In fact, less than half of utility construction is paid for from retained earnings, depreciation funds, and other internal sources. Most of the funds must be obtained in the capital markets.

When you consider that the electric utility industry, now representing assets of over $40 billion, is expected, at least, to double in size over the next ten years, you can see that to raise the required capital will take a lot of long-range planning. Within our own company, new electric construction expenditures during the next five years are estimated at a minimum of $200 million, compared to present electric plan of $330 million.

Our objectives, like that of all other business concerns under our free enterprise system, are threefold, each being equally important and dependent on the other. That is, we must provide the best possible service to the public at the least cost practicable. We must provide a fair and equitable livelihood to our employees; and, thirdly, we must be able to provide an equitable return to the holders of our securities. To accomplish all three, we must fairly match the interests of our customers, employees and investors. Through long-range budgets, or forecasts, we attempt to plan our future operations in a way that will be of maximum benefit to all of these groups.

PLAN OF ACTION

Basically, we, like almost all utility companies, regularly prepare four budgets or plans of action. These are the operating budget, construction budget, cash forecast and capital forecast. These are prepared annually for the succeeding five year period. In addition to these regularly prepared budgets, we periodically project our potential electric generating capacity requirements for a period of twenty-five years into the future.

Among the purposes of the 25 year estimate is planning the location of future generating plants, which must be near a large supply of water and, in our case, near an adequate supply of cheaply transportable coal.

Once the five year budgets are prepared and approved, no changes are made unless an unexpected circumstance arises, which would necessitate a substantial revision. For example, a general wage increase would cause us to change our operating budget, or a material change in the construction cost of a generating station, large substation or of major transmission lines would require a change in our construction budget.

Similar to the operating budgets of most business enterprises, our five year estimates are based on estimates of sales volume. The sales forecast is the beginning of a chain of many events. It determines our estimated revenues, the amount of coal required to generate the necessary electricity, the volume of natural gas to be purchased as well as the normal related operating expenses and taxes. It also determines the maintenance schedule of the various generating units in our three stations.

BUDGETS AND RATE INCREASES

In the utility business, the operating budgets serve a purpose not required in non-regulated industries. That purpose is to point out those areas where action should be started before regulatory agencies to obtain rate increases, if necessary and justified.

As previously pointed out, the rates or prices public utilities are permitted to charge for their products are regulated by public utility commissions. The rate proceedings sometimes are long, drawn out affairs. For example, we filed a request in April, 1958 for an increase in electric rates and, after a long delay and protracted hearings before the Ohio Commission, we were allowed to begin collecting higher rates in April, 1960, a time lapse of two years.

During this period, we were unable to curb the ever-increasing labor and material costs of operations and construction, plus the fact that the Company lost several millions of dollars in revenue because the regulatory commission was unable to act more promptly.

Proper long range planning which will indicate well in advance the need for a rate increase, can alleviate to a certain extent the loss of earnings resulting from this regulatory lag.

From the operating budgets, we can also estimate the amount of capital which will be generated from internal sources, such as retained earnings and depreciation funds, which can be invested in additional plant to serve our customers and reduce the amount of additional capital required from outside sources. Furthermore, projected earnings indicate to management the amount of additional capital that can be supported.

CONSTRUCTION PLANNING

The five year sales estimates are also used as the base for developing our construction budgets, which are prepared by the operating departments responsibile for supplying the gas and electric requirements of our customers. Here again, it should be pointed out that we cannot plan to supply only that volume of sales which would be particularly profitable; instead, we must always have plant facilities that at all times are adequate to serve the needs of all our customers. Since it takes at least three years to plan and construct an electric generating station, you can see that accurate estimates of future demands are very important.

Because it is necessary that utilities be able to supply the full requirements of all customers at all times, a reserve capacity of about 15% must be included in the total capacity of the generating plant to provide for emergencies in case of breakdown and for maintenance purposes. We try to have generating capacity adequate to take care of our customers' maximum requirements with our largest generating unit out-of-service.

Construction planning consists not only of plans for building generating stations, but also for constructing facilities for transmitting gas and electricity to those areas where it will be required, and for the facilities necessary for distributing the service to the ultimate consumers. Studies must be made of the growth patterns of the various communities served in order that plans can be formulated to extend facilities to those areas where houses will be constructed, and commercial and industrial demands created.

CASH REQUIREMENTS

The construction plans of the various operating departments are accumulated and assembled to determine the overall cash requirements to finance the plant additions. These cash requirements are then coordinated with regular operating cash requirements and with cash sources to form the cash forecast.

Only major items of cash sources and requirements are reflected in the cash forecast. The primary sources of cash to utility companies are net earnings from operations (as shown by the operating budget) and depreciation accruals, which amount to a substantial figure because of the large plant investment. The remaining principal source is funds raised from the sale of securities. The primary cash requirements, over and above operating expenses and taxes, are of course, for construction of plant. Thus, the cash forecast indicates in a timely manner, the estimated cash requirements for each year to the men responsible for obtaining outside funds, and permits them to plan their negotiations to receive the most favorable consideration in the money market.

Although the earnings of utility companies are limited by regulation, they usually pay dividends on common stock equal to about 70 to 75 percent of earnings available to the common stock. Therefore, as pointed out earlier, retained earnings are a very inadequate source of funds to pay for the large plant investments which are required. Fifty percent or more of construction requirements are paid for from funds obtained from the sale of securities. Thus, we come to another important phase of long-term planning, that is, the composition of our capital structure.

CAPITAL STRUCTURE

Again as pointed out earlier, because of the essential nature of the services rendered, utilities have a relatively stable income. As a result, the capital structures of utility companies usually differ from those of non-regulated companies in that they contain a large amount of permanent debt. This permanent debt ordinarily is in the form of mortgage bonds or debenture bonds.

Relatively stable income enables utilities to support the interest charges on a large amount of debt with a fair degree of safety. It is unlikely that earnings would be depressed over an extended number of years to the point where it would be impossible to pay the interest charges.

However, we, like all investor-owned enterprises, are in business to make a maximum profit for our common stockholders. Having a large amount of debt in the capital structure enables us to earn more for our common stock. For example, assuming a capital structure of 50% debt and 50% common equity, if the average interest rate on the debt portion is 3%, and we can earn 6% on our overall capital, the return on the common equity portion would be 9%.

Our long-range objective is to have a capital structure of 50% debt, 35% to 40% common equity, and the balance preferred stock.

This type of financial structure is considered very sound by financial analysts and investment dealers, and because of this, our Company has enjoyed a Aaa rating of our bonds by Moody's Investor Service, the highest rating a company's debt securities can attain. The excellent financial rating, which our company has developed since 1946 when the Cincinnati Gas & Electric Company became an independent utility, is extremely important because it results in a lower cost of money to our Company when outside financing is required. Because a utility company is very dependent on outside sources of cash to build its plant facilities, it is essential to maintain a high rating in the money market.

The five year cash forecast indicates the amount of funds we will require from outside sources, which is then projected into a capital or capitalization forecast to conform to our long-range objectives for our capital structure. And finally, the interest and dividend requirements of this expanded capital structure are estimated and then checked with our operating budget to verify that earnings will be adequate to meet these requirements. Thus, our planning comes around in a full circle, tying our long range objectives for maintaining a sound capital structure right in with one of the fundamental purposes of our operating budget, that of indicating a profit level sufficient to support the necessary expansion of our business.

That concludes my discussion of our planning efforts, which, I think, involve the principles applicable in planning for the future of any company. For, ladies and gentlemen, as you have heard before, the anticipated expansion of the whole economy holds great promise for all business. But the realization of this promise for the individual company will require expert judgment and careful interpretation to translate this overall growth into meaningful, useful terms. This is the critical and important job of forecasters and budgeting people in every business enterprise.

THE P/V RATIO AND PROFIT

E. H. Smedley, Addressing the 10th Annual Conference NSBB, Cincinnati, Ohio.

Mr. Smedley graduated from the University of Cincinnati with a degree in Mechanical Engineering in 1926. For a number of years he was associated with Link Belt Company in various sales and engineering capacities dealing with the development and application of mechanical power transmission and material handling equipment.

He was subsequently employed by the National Pump Corporation, manufacturers of pumping and metering equipment for petroleum products, and ultimately carried the responsibilities of General Manager.

Twenty-two years ago he joined the management consulting firm of Stevenson, Jordan & Harrison, Inc. During this period he has dealt with a wide range of operating problems in business and industry and is presently senior partner in charge of the Cleveland operations of his Company.

Mr. Smedley was associated with the original research from which the Profit-Volume concept was developed for the planning and control of profit.

Early in my career as a consultant I had the good fortune to be associated with Mr. C. S. Carney of our Company who originated the P/V concept, which has since become widely used by our clients and continues to have increasing acceptance throughout business and industry. I became very enthusiastic about the value of the P/V ratio if properly used.

The current enthusiasm for "direct" costing makes it somewhat easier to accept and use the P/V technique; but direct costing alone does not yield the required insight at the policy-making level unless used in conjunction with the P/V concept as evolved during the interim years of practical experience.

In 1940 I participated in a survey for one of our clients in a process industry. He had no organized cost system and I suggested that he ought to have one.

He replied: "I don't need a cost system. My wage scales are lower than the industry and my supervision is efficient.

"Material is a large part of my cost and I know I buy it as cheaply as anyone. I don't waste any.

"Very little overhead is controllable — mostly it arises from necessary heavy investment in facilities.

"My selling prices are on a par with competition, as they must be, and my plants are running 24 hours a day and 6½ days a week. "What do I want with a cost system?"

My supervisor saw that what he *really* needed was P/V ratios; he needed them by products; he needed them by plants and he needed them by market areas — *and* he needed to *use* them!

To make a long story short, he got them and used them — and he very substantially improved his profit with no change in prices, in costs nor in volume!

Quite a few years later a client in the corrugated box industry had successfully executed a program to increase the sale of high-profit items — and his profits fell sharply!

He, too, used P/V's to correct the trend and wound up with higher profits than ever. Incidentally, he already had a very good cost system.

What is this magic of P/V?

It is really quite simple. Sometimes I wish it were more complicated. P/V's solve complex matters relating to profit in such an easy and accurate manner that many executives find it difficult to believe until after they have used them. Then their enthusiasm becomes as great as mine.

Let's have a few definitions so we will all speak the same language.

1. "Variable Costs" are those which vary in relation to volume or level of activity.
2. "Profit Contribution" (or P.C.) is revenue minus variable costs.
3. The "P/V Ratio" is profit contribution divided by revenue.

To illustrate, if all variable costs amount to $80 and an item sells for $100, the profit contribution is $20; and $20 divided by sale price of $100 gives a P/V ratio of 20 percent.

P/V ratios can be prepared for a product, a product line, a facility, a sales territory, a plant, a division, an entire company or any other functional entity affecting profit.

That is just about the whole story on the P/V ratio. Now, what is profit?

The classic definition is:

(Profit) equals (Revenue) minus (Cost)

or, we can say

(Profit) equals (Revenue) minus (Variable Cost) *and* minus (Fixed Cost).

Since (Revenue) minus (Variable Cost) equals (Profit Contribution), our new profit formula is:

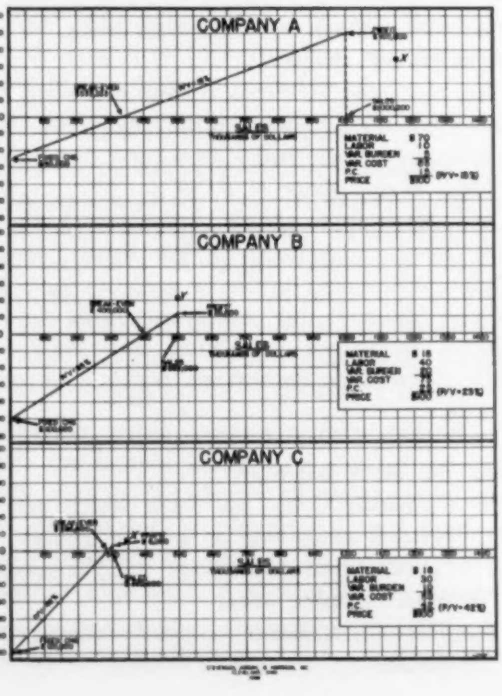
(Profit) equals (Profit Contribution) minus (Fixed Cost).

It is now obvious that maximizing profit contribution will minimize profit. We all know that maximizing revenue does *not* necessarily maximize profit.

Now we have the whole story. No one knows more about P/V and profit although some of you may be more experienced than others in using these modern concepts.

But to stop here would be like the story about Calvin Coolidge when he was walking home from church. A friend asked him what the sermon was about. Collidge replied:

EXHIBIT NO. 1



"Sin and virtue."

His friend inquired — "What did the preacher say about sin?"

"He's against it."

Well, then what did he say about virtue?"

"He's in favor of it."

So let's take a little time to explore the sins of operating a business without P/V and the virtue of using P/V's.

Maximizing P.C.

Since profit is maximizing P.C., it is interesting to see how this can be done. There are only four ways:

1. Reduce variable costs.
2. Increase sales prices.
3. Increase sales volume.
4. Improve product mix.

A combination of these four methods is usually employed.

The effects of reducing costs and of increasing price is well understood.

We shall deal at length with the problems of volume and of product mix later.

The Profit Diagram

Once the concept of the P/V ratio has been grasped, it is possible to make a very simple profit diagram which is extremely useful because it permits almost instant evaluation of the effect on profit of almost any proposed move which bears upon costs, prices or volume. Furthermore, executives, who must make decisions based upon information presented to them, need not be sophisticated in accounting techniques to understand the effects.

Exhibit I shows the profit diagrams for three separate companies.

For the sake of simplicity, we will assume for the moment that each of the three companies has only one product.

Referring to Company A, sales are laid off on the horizontal scale. Sales amount to $1,000,000 per month. The fixed costs are laid off on the vertical scale downward from the origin and amount to $50,000 per month.

From the cost data, we find there is a total of $85 of variable costs per $100 of sales so that the P.C. is $15 and the P/V ratio, therefore, is 15 percent ($15 divided by $100). Starting at the $50,000 of fixed, a line is drawn at a slope of 15 percent, which is the P/V ratio. The breakeven volume is $333,333 of sales and profit at $1,000,000 sales is $100,000.

We can now read the profit at *any* sales volume on this vertical axis without going through any calculation relating to over-or-under absorp-

tion of overhead, or point on sales, or anything else.

We can also immediately see the effect on profit and on the breakeven point for any change in the fixed costs as this merely changes the starting point on the left-hand axis, the sloped line remaining parallel to the one already drawn.

Also, if we change the variable costs, or the price, we will have a corresponding change in the slope of the line which can be easily calculated and drawn in the same manner as previously explained. Having drawn the new slope line, we can quickly read the new breakeven point and the new profit.

It is convenient at this point to introduce another definition, the margin of safety. The margin of safety is the amount of sales which can be lost before reaching the breakeven volume. In the case of Company A, this is $666,667.

Note that Company B has a much lower margin of safety, and Company C has a very small margin of safety, even though the P/V ratio in both cases is higher than for Company A. It is evident that Company C, for example, would profit handsomely from a slight increase in volume, whereas a comparable increase in volume for Company A would not add so much to profit. An additional $100 sale increases Company C's profit by $42!

Examples of the Use of the Profit Diagram

A. A sales manager has determined that a five percent price reduction will increase sales by 15 percent. Is it wise?

Company A has a profit of ten percent on sales, and Company C has a profit of only two percent on sales. It seems that, with only 15 percent volume increase, the move may or may not be wise for Company A, but certainly a five percent price reduction would be disastrous for Company C.

Let us see what the facts really are.

	Company A	Company C
Price drops to	$95 per unit	$95 per unit
P.C. drops to	$10 per unit	$37 per unit
P/V drops to	10.53% (10/95)	39% (37/95)

Drawing the new slope lines and extending them both to the 15 percent volume increase, we arrive at points X (Exhibit I). It is quickly apparent that the total profit for Company A would be seriously diminished and total profit for Company C substantially *increased.*

In Company A, profit drops from $100,000 to $71,000; but in Company C profit increases from $6,000 to $14,550.

The answer to the sales managers' proposal in Company A is not to reduce prices. In Company C, the answer is the opposite; profit will be more than doubled. *This is precisely opposite to the conclusion that would have been reached without P/V's.*

B. An increase in the advertising appropriation of $10,000 per month is under consideration. How much additional sales are needed to offset the increased appropriation?

It is common to establish advertising budgets in terms of percent of sales. With this type of thinking, since Company A's sales are about three times the sales of Company C, there is at least an inference that Company A can more readily increase its advertising appropriation, particularly because the absolute amount of profit is so much greater.

However, Company A has a 15 percent P/V ratio. Dividing the proposed increase in appropriation by 0.15, we find that $66,667 of additional sales are required to just offset the increase.

Company C enjoys 42 percent P/V ratio and therefore would need only $23,800 in increased sales to offset the appropriation. Using the graphic method, all one needs to do is to draw the slope line parallel to the one shown on Exhibit I so that it starts from the lefthand axis at the point $10,000 lower than shown on the chart, and it is then possible immediately to read the sales volume required to make the same profit as shown on the chart.

However, regardless of whether the graphic or mathematical approach is used, the main point is that *the P/V ratio leads to an accurate determination which is quite different from the answer that ordinarily would be secured.*

C. A redesign of product is contemplated which would save ten percent of materials and five percent of labor. Development and retooling costs would be $20,000. Should the move be made?

Let us now compare the situation for Company A and Company B. Of course, using the tabulations which appear on Exhibit I, it is not necessary to use the P/V

method to decide that it would be a good move. The new profit in Company A would be $175,000 and $42,500 in Company B.

However, additional light is thrown on the matter by referring to the profit diagram. The new profit would be as indicated by the letter "Y." The breakeven for Company A would drop to $222,000. While this is a welcome reduction for Company A, this company already has a very adequate margin of safety — but since Company B's margin of safety was dangerously small, the lower breakeven point and consequent increase in margin of safety is quite important in strengthening the profit structure.

Note also that if Company A's sales had been $500,000 (the same as Company B), the reduction of breakeven point and the consequent improvement in the margin of safety would be extremely important to Company A.

The P/V concept permits evaluation of the proposed reduction in costs in terms of the entire profit structure of the enterprise, as well as the obvious improvement in the profit.

D. The question of expanding the sales force is often a troublesome one. In Company A profits are ten percent of sales, and in Company B, five percent of sales. Assuming that it costs $10,000 a year to support a salesman in the field, it would require $100,000 of additional volume for Company A to just pay for the addition of one salesman and additional volume of $200,000 for Company B. It would take considerable amount of courage to add a salesman when the average salesman now is producing only $60,000 of sales.

But note that Company B has a P/V ratio of 25 percent; therefore, additional volume of $60,000 yields additional P.C. of $15,000 which leaves $5,000 additional profit *after* paying the $10,000 cost of a salesman. Furthermore, a needed improvement in the margin of safety would result. It *is* wise to add a salesman.

On the other hand, Company A, with only 15 percent P/V ratio would have $9,000 additional P.C. at a cost of $10,000 for the salesman. It would *not* be wise for Company A to make this move.

These sound decisions contrast sharply with the ordinary approach which, as we have seen, indicate that in neither company should a salesman be added, and most certainly not for Company B.

For this particular problem, a note of warning should be given. Even assuming an adequate market potential, if a great number of salesmen are added, it will inevitably reflect in greater clerical and administrative costs which could increase the fixed charges to some extent although such an increase rarely occurs with the addition of only one or two salesmen. However, if the expanded sales force does require more fixed charges in the home office, it is very easy to see the effect on the breakeven point, the margin of safety, and the profit by simply starting the slope line at a point in the left-hand axis lower than shown on Exhibit I by the amount of anticipated increase in fixed costs.

I am aware that each of these examples can be analyzed without the use of the profit chart and the P/V concept. Although in some cases the analysis might become rather involved by ordinary methods, any competent accountant can do it. However, it usually is quite difficult for those not sophisticated in accounting procedures to understand some of the involved calculations, particularly as they relate to under-and over-absorption of overhead.

All too often, executives faced with making decisions use conventional cost and profit-to-sales percentages and do not even realize that a special analysis is called for. It has been our experience that after any executive once comprehends the simple P/V technique, it is much easier for him to gain a real understanding of the facts and he will make better decisions.

Product Mix

When we approach the problem of product mix, it becomes extremely difficult even for those thoroughly versed in accounting procedures to comprehend the effect of a change in product mix on profit and on the profit structure of the enterprise.

The P/V concept does a great deal to clarify this problem and usually leads to more valid conclusions.

The XYZ Company has three products (or product lines). Detail of cost, price and profit is shown on the upper section of Exhibit II. The fixed burden is exactly absorbed at the sales volume indicated. Total fixed burden amounts to

EXHIBIT NO. 2

THE XYZ COMPANY

ITEM	PRODUCT A	PRODUCT B	PRODUCT C	SUMMARY
DIR. MATERIAL	$ 70	$ 15	$ 18	
DIR. LABOR	10	40	30	
VAR. BURDEN	5	20	10	
FIXED BURDEN	5	20	40	
TOTAL COST	$ 90	$ 95	$ 98	
SELLING PRICE	100	100	100	
PROFIT / UNIT	$ 10	$ 5	$ 2	
UNITS SOLD	10,000	5,000	3,000	
PROFIT	$ 100,000	$ 25,000	$ 6,000	$ 131,000
SELLING PRICE	$ 100	$ 100	$ 100	
VAR. COST / UNIT	$ 85	$ 75	$ 58	
P.C. / UNIT	$ 15	$ 25	$ 42	
TOTAL P.C.	$ 150,000	$ 125,000	$ 126,000	$ 401,000
			FIXED CHG.	$ 270,000
			PROFIT	$ 131,000
UNITS SOLD	3,000	5,000	10,000	
"PROFIT" / UNIT	$ 10	$ 5	$ 2	
"PROFIT"	$ 30,000	$ 25,000	$ 20,000	$ 75,000
P.C. / UNIT	$ 15	$ 25	$ 42	
TOTAL P.C.	$ 45,000	$ 125,000	$ 420,000	$ 590,000
			FIXED CHG.	$ 270,000
			PROFIT	$ 320,000

$270,000 per month and the profit is $131,000 per month.

The second set of calculations develops this same profit figure by subtracting the total fixed of $270,000 from the total P.C. of $401,000.

From the first set of figures, product A shows a profit of ten percent on sales, and product C has a two percent profit. It is only natural that the sales emphasis be placed on promoting product A and that product C be de-emphasized.

The P/V concept shows this to be precisely the wrong course to follow.

To the executive familiar with P/V's, it is perfectly clear that product C is the one to push because it has a P.C. of $42 per $100 of sales (P/V ratio of 42%) whereas product A has only a 15 percent P/V ratio.

Let's see what would happen if sales of product C were increased to 10,000 units and sales of product A reduced to 3,000 units, holding the original volume of 5,000 units of product B. Total sales will be the same.

Extending the units by the 'profit" per unit, we have $30,000 of profit in product A, product B remains the same at $25,000 "profit" and the "profit" on product C rises to $20,000. It appears that the total company profit would fall from $131,000 to $75,000.

But note what happens when the units are extended by the P.C. per unit.

As shown at the bottom of Exhibit II, the total P.C. rises to $590,000. The fixed burden, of course, remains the same at $270,000 so the profit is now $320,000 instead of the original profit of $131,000.

The significant fact is that this profit improvement has been accomplished by following precisely the *opposite* course from the one indicated by the usual approach. Perhaps even more important, the desirable course of action is clear to any executive — the high P/V product is the one to push.

The accountant, of course, could arrive at the same conclusion by pointing out that burden would be under-absorbed on product A and over-absorbed on product C so the net over-absorption amounts to $245,000 which, if added to the indicated profit of $75,000, would result in a net profit of $320,000. But it is most unlikely that executives at the policy-making level would ever think of emphasizing a two percent profit item at the expense of a ten percent profit item and consequently would not ask for such a recalculation. Further, the recalculation would have to be made over and over to determine the true effect on profit for all product mix combinations that may be considered while planning sales strategy or that will occur during the execution of any plan.

For companies having a complex operation involving a number of cost centers or a large number of products, the chore reaches astronomical proportions.

In contrast, figures presented on the P/V basis are valid at *any* volume and for *any* mix or products — and the effect on profit can be determined by simple arithmetic. All the executive has to remember is that profit is maximized when the P.C. is maximized.

The P/V concept provides a superior means of communication between executives at the policy-making level and those who know and understand the detail and implications of all the facts entering into the calculations of "cost" and "profit."

By this time you have all probably noted that the figures for products A, B and C of XYZ Company (Exhibit II) are identical with the figures for companies A, B and C of Exhibit I. As we have seen, Company C needs volume. Is it not also reasonable that Product C should be promoted?

In discussing product mix, the conclusions are sometimes questioned on the basis that some idle plant should have been initially charged to Product C or it is assumed that, to create the capacity to triple sales, additional facilities will be needed with the accompanying increase in fixed costs.

First, let me say that the example presented in

Exhibit II is an actual case history. There was no change in company fixed costs nor in variable costs of the products. We have had many other similar experiences.

However, it is true that in some companies a *drastic* change in mix does alter some costs such as supervision, maintenance, shift premium, etc., but I do not recall a single case where such changes materially affected the results. Taken all together it is inconceivable that the changes in cost can amount to 27 percent of sales. (The P/V ratio of product C is 27 percentage points higher than product A).

The planning for more profit by improved product mix must not be confused with profit planning associated with investment in new facilities. Full discussion of this subject is too lengthy to include in this paper; suffice it to say that the P/V concept is quite useful in decision making related to investment in new facilities.

P/V's also clarify the complex problem of the impact on profit when segments of production facilities reach practical capacity. This involves questions basic to the structure of American industry and also is worthy of full exploration.

Returning to the subject of this paper, refer to Exhibit III. This is a picture of the data of the upper part of Exhibit II and is even more easily used by most executives in formulating policy regarding product mix. The contributions of Products, C, B and A are represented by the three segments of the slope line. It represents the initial product mix.

Since the slope of segment C is steeper than the slope of segments B and A, it is self-evident that increasing volume on product C will yield a greater increase in profit for either of the other two products.

Exhibit IV shows graphically the P.C. for each of the three products and the total profit after the mix has been changed to 10,000 units of product C, 5,000 units of product B and 3,000 units of product A. The chart tells the same story as the figures at the extreme bottom of Exhibit II. It shows how profit has been maximized by maximizing P.C. through the process of improving the product mix.

Note also that the breakeven volume for the company is now approximately $1,212,000. Not only does the company make more profit at any volume but also the volume can shrink considerably lower before going into the red.

A dramatic shift in product mix, as illustrated by this example, is very seldom accomplished quickly. The important point is that policies be established so as to pursue a trend in the correct direction rather than inadvertently in the wrong direction.

OTHER USES OF P/V

In addition to the examples presented in the foregoing, the P/V technique has important implications on decisions relative to market expansions, sales territories, plant locations, capital investment — indeed it is useful in any matter bearing upon planning for the maximum obtainable profit from the operation of the enterprise.

I want to mention one other use that is of cur-

EXHIBIT NO. 3

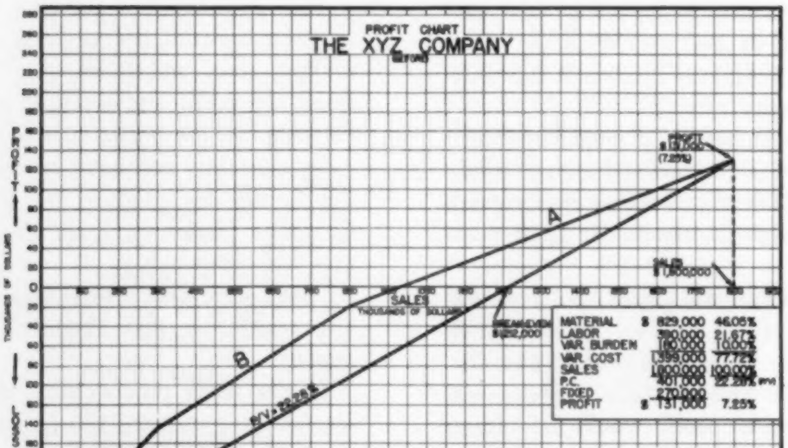
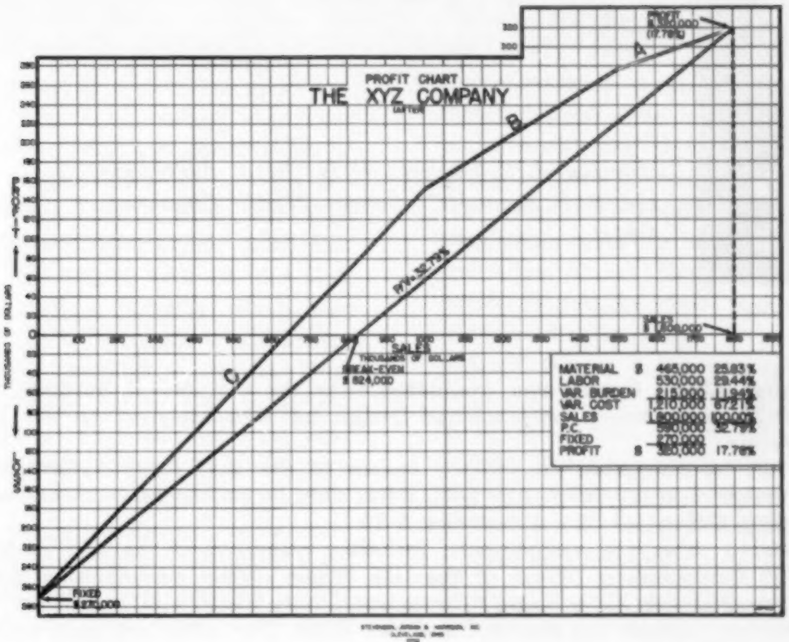


EXHIBIT NO. 4



rent importance to a good many companies. If you will plot quarterly profit figures (before income tax) for your own company for the last 24 quarters against sales volume and then draw a line of best fit to the first 18 points, you will have a crude sort of P/V chart. If your company is typical, the last six points will tend to fall below the line. In our long period of boom times, profits have been maintained at a seemingly satisfactory level largely by reason of increased volume but the underlying profit structure has often degenerated.

Usually the erosion has been gradual and unnoticed until volume has slacked off or just failed to rise at the customary rate.

While this simple chart will not tell how much of the degeneration has resulted from increases in fixed costs and how much from a narrowing spread between revenue and all variable costs, it will probably show that some drastic action is indicated if a satisfactory breakeven point and margin of safety are to be re-established.

A recently published article stated:

"When business historians look back over the past decade, they are sure to be struck by the unprecedented growth of company after company and industry after industry. They will, no doubt, be impressed by the extraordinary benefits brought by this rapid expansion; but they will certainly note that it carried a cargo of problems as well.

"Not the least of these has been the encrustation of many firms with procedures, people, and services that have added many dollars to operating expenses without producing any corresponding income — or, at least, not enough to justify the expenditure. When a company is growing fast and making money, these barnacles accumulate and no one cares very much. In quieter or less prosperous times, the business managers have both the opportunity and the incentive to check their organizations periodically and scrape them clean; but with the pressing problems of growth occupying all their attention and the profits continuing to mount up, the antifouling job is often neglected.

"Furthermore, this expansion has been taking place in an environment of ever-accelerating change. Under these circumstances, once-important activities become outmoded almost overnight; thus, company after company has accumulated encumbrances too heavy to carry today."

Much of our consulting work in recent months has been to assist our clients to correct such conditions and to re-examine policies relating to product mix and the corollary problems of marketing.

Each of us has a special responsibility today to his own company — and to himself — to take an especially hard look at profit leaks which have crept into his business and to search out the opportunities for profit improvement. With very few exceptions, the opportunities are there. The P/V technique is one powerful tool which can be used for this purpose.

PROFIT SHARING

Admiral A. C. Burrows, USN (Ret.), Addressing the 10th Annual Conference NSBB, Cincinnati, Ohio.

Admiral Albert C. Burrows graduated from the U.S. Naval Academy with the class of 1928. Upon being commissioned Ensign he was assigned to the battleship USS California.

In 1931 he completed the officers' course at the U.S. Navy Submarine School and was assigned to the Submarine S-32. After duty in various other ships, he became Commanding Officer of the Submarine S-26.

Following other sea assignments, including command of the USS Swordfish, he reported as Commanding Officer of the USS Whale. While commanding the Whale, he was awarded the Navy Cross "for extraordinary heroism in connection with military operations against the enemy," and the Silver Star with two gold stars in lieu of additional Silver Stars for "distinguishing himself conspicuously by gallantry and intrepidity in action." In ceremonies awarding the Navy Cross to Admiral Burrows, "Fleet Admiral Chester W. Nimitz described the Admiral's submarine as a "a whale of a ship." Under Admiral Burrows, and at a time when submarine action was the United States' chief offensive of the war, the USS Whale completed numerous successful war patrols.

Admiral Burrows retired from active duty on 28 June 1958 and became the first President of the Council of Profit Sharing Industries and President of the Profit Sharing Research Foundation on 1 August 1958. The Admiral and Mrs. Burrows now reside in Lake Bluff, Illinois.

Thank you, Mr. Chairman. Members of the National Society for Business Budgeting and Distinguished Guests: The mention by your Chairman of going into the Alaskan Command reminds me that I am still so close to the Navy that it is awfully good to run across an old shipmate. Then I feel that I have got a nucleus of some friends. I had the great pleasure of being taken to dinner at the Gourmet Room by an old dear submarine shipmate, your good member, Hugh Lansman, last night, and that took me back to something that I experienced with the Air Force.

I had arrived in Alaska about a week before this incident and I had read until quite late, about 12:30. Then I decided to take a shower before turning in. I turned on the water and tried it tentatively, as we will, and to my astonishment the water was cold. At that time of the year, February, on the mainland of Alaska, the outside temperature was about 27 degrees below. When I say that the water was cold, I mean it was cold. The method of heating the water was through the furnace and the furnace was ordinarily quite efficient, so I reasoned that if the water wasn't hot, which it wasn't, that the furnace must not be running. It wasn't.

Now I hadn't been on the air base very long, but there was one thing that I had caught onto and that was if you are going to get along on an Air Force Base, you had better find out what Sergeant runs what. I went and called the proper number, and I thought I had identified myself as the Senior Naval Officer on this combined staff, and the Sergeant said, "Well, I will tell you, Captain, you sure picked an awful night to run out of fuel oil. Look, I got something like 14 trucks all over this great base and I have got them stuck in snow and I have them in ditches — and I have a fellow here who has two wheels down someplace, I think in the foundation of a house. What's more, I have called everyplace. I will tell you what I will do. I'll do what I can, but I can't promise you. Look, Captain, we even got Majors who have got no fuel oil."

SUPEREROGATION THROUGH MOTIVATION

With the introduction of your Chairman, in very real humility I feel it encumbent upon me to explain to you why I am taking the time of you gentlemen this morning to speak about a subject which you might well reason is far removed from the Naval Service. From the very beginning of my service, immediately after the Naval Academy, I was struck with an idea and it was the aborning of a curiosity which has stayed with me until now. If we take a submarine, and there were six of them in a division, they were built from identical plans. The crews assigned to those ships — first, they were all volunteers from people recommended by their commanding officer — went through the same physical, professional, psychological and other testing procedures. They went through the same kind of training and finally they were assigned by lot to those ships. All of these submarines were good, but invariably there was one which was outstanding. Why? The crews of those ships knew that there was nothing within the power of their skipper to raise their pay. Their pay for the performance of their job was exactly the same as that received by anyone else for the same kind and type of duty. And yet this crew of the outstanding ship did everything just a little bit better. If there was an extra job to do, this ship would volunteer for it, not because the skipper was out to make his number, but everybody backed up the skipper in works of supererogation; the number of absent without leave people, the number of people absent over leave were practically nil.

One ship I have in mind. They were outstanding in gunnery, in torpedoing, in signals, in communications and all of those various factors that go to make for excellence of performance. What caused this? The reason, I have come to conclude, is a very small thing but its importance is tremendous. In the one case there was somehow engendered a will to do. A will to do. A motivation, to use a modern word; a spirit, an interest above and beyond what was ordinarily acceptable. Certainly supererogation is the word.

THE CLASSICAL ECONOMISTS

In a long career in submarines, I found that there were a number of rather simple things that one did. Outstanding among them is when you go through the boat — and this is analogous of going through the plant, going through the store or going through the laboratory, or whatever it is where there are people — the interest and the curiosity, the sincere curiosity to ask a question and, having asked it, to have the patience, the sincere patience, to listen to the answer. The two things I think that are pointed out by that experience are, one is interest and the other, the giving of the opportunity to participate. It is on the basis of this inquiry that I was brought into association with the Council of Profit Sharing Industries. David McCardle, perhaps the most outstanding of the physiocrats, the classical economists of England, said, as perhaps everyone of you will recall, "Labor, like any other commodity which is subject to increase or decrease, has a going or market value. The market value of labor is that wage which will permit the workers, one with another, to subsist and to reproduce his kind without increase or diminution."

That at a level of existence came to be known as the iron law of wages. This was mixed into the observations of Malthus, who reasoned that if you increase wages, then the population is going to increase, and with an increased population, you have more labor. Therefore the wage falls. So it is a never-ending cycle, a cycle of misery and human degradation.

BIRTH OF COMMUNISM

Karl Marx picked up those arguments, the observations of Adam Smith and David McCardle, and he approved of them. In large measure he approved of them because they were not laws, really; they were in truth observations. They were the things that were happening before the eyes of those who had the wit to see them. The difficulty and the erroneous conclusion lay in the fact that they didn't have to be that way. They reasoned, too, that if profits went up, wages had to go down. If wages went up, profits had to go down.

In 1864 in a convention in London, we had the formulation of the first Communist-Socialist platform, and it consisted principally of two planks. One of them was the observation that because the tools are owned by capital, that labor will be ever subservient to capital and will be kept in social and political decline, proceeding further down that slope as time goes on.

The other observation was one which we are coming to grips with this very day because labor is thus downtrodden by the owners of the tools and the only salvation is that all workers everywhere must maintain a militant solidarity. Marx, of course, said that capitalism had within it the seed of its own destruction. He said that worker

does not get all the values by which he increases the selling price of an object upon which he works. He does not get the profit.

In this country, we have come a long way from the observations of the classical economists. We have come a tremendous way from those sad pointings of the Communist. Why? In the first place, we were a new country. If a man did not want to work under the terms and conditions along the Eastern Seaboard, there was always the opportunity for him to push westward, to clear land and to work for himself.

An interesting sidelight on this actually happening in our country was the theory of Von Tenon, a very distinguished agricultural economist of Germany, whose views on marginal utility are taught in our agricultural schools and in other schools, for that matter. Von Tenon, the first to use higher mathematics in economics, wrote a book, "The Natural Wage." Later this summer that book, though first published in Germany in the latter part of 1859, will make its first appearance in the English language. In that book he lays the theoretical basis for profit sharing. He has a formula for the natural wage.

EARLY EXAMPLE OF PROFIT SHARING

In other words, he concludes that a man must be given a wage and in addition thereto, an interest. It is worth noting that in all of the long experience of profit sharing, the basis of it has been not the classical reasoning of the economists but very practical apparent solutions as people went along. For instance, in 1841 the young French decorater Edmund John LaClaire wrote to everyone of consequence in France at that time and posed this question: The correspondence still exists. "What if I try to get the interest as an owner of my workmen by giving them a share of my profits?" There was not one figure in the political, philosophical or literary field in France who did anything but discourage LeClaire in such a question. Finally, as he set it forth himself, "It seems to me that if a man were given a share of the profits, he might achieve, knowing the habits of the journeyman, about an hour's extra real work a day without overtaxing him. He might achieve, too, a very real saving in the use of materials and another saving in the care of the tools." He recognized these savings, multiplied them by his work force of 300 and multiplied that by the number of work days in a year and he decided, against the advise of everyone, to try it, to test it against his own pocketbook. He did. It was the beginning of a marvelously effective system of sharing the proceeds with the workmen in addition to a going wage. He set his company up to operate on this basis and it existed long after his death, a very prosperous concern. Just before the death of LeClaire, he uttered these words, "I have been called an idealist, I have been called a dreamer. Let me tell you this. I have proved throughout a long lifetime that it is better for me to earn 100 francs and give 5 of them to my workmen than to earn 25 francs and keep them all for myself."

HUMAN DIGNITY

By profit sharing we do not mean merely the sharing of money. As I brought out in my remarks about the submarines, money was simply not the motivating factor. It is our belief that today money is well down the list in the real moving forces of everyone of us. What do we want? We want to feel that our fellows grant us that motive of human dignity with which the good Lord put us here. We want to have the opportunity to achieve the highest aspirations of man. We want to contribute and we want to feel that our contribution is both known and appreciated.

Profit sharing is essential because it follows the rewards of our production, but it is no more essential than information sharing. What is going on? Every one of us wants to be taken into the confidence of our organization. We want to know what is going to happen. We have a vague feeling, every one of us, from the top to the bottom, that the production of goods and services is an admirable thing, it's a good thing, but we want to know the facts about that production and we don't want to hear them through the grapevine. We want to be able to offer our observations and our suggestions.

MANAGEMENT RESPONSIBILITIES

I might say that profit sharing should not be taken by management as an easy thing. It is not. This system of copartnership, of telling everyone in the organization that we are on one team for one purpose carries with it some awesome responsibilities. It carries with it the responsibility to answer the question when the worker says, "Do we have to be this stupid?" Some concerns make it easier for an employee to offer a suggestion than others. I recall one time in the days before the prevalent use of airplanes at sea, I was on the flagship of the Pacific fleet, the California. We were on a fleet problem. We had been out some seven days and information was

very sketchy. We had not made contact with any ship of the enemy fleet. About 2:00 o'clock in the afternoon the lookout in the foretop sung out, "Ship two points forward on the starboard beam. On opposite parallel course."

The Commander-in-Chief, a superb and capable Admiral, put his own long glass up against the stanchion, took a good look and in a voice that could be heard from stem to stern, said "Opposite course? She's on the same course." The Chief Signalman who had come into the Navy some 38 years before as a young signal boy, was standing right beside the Admiral, and he laid his long glass against the Stanchion. "You are right, Admiral, but it's the first time I ever saw a ship with the smokestack forward of the bridge."

What would you expect in a company with a profit sharing plan where the Chairman of the Board, the President and everyone in authority believes in it, where they believe in it to the point it is going to work? You would find, and this experience is corroborated in the minds of the members of the Council of Profit Sharing Industries, that ways to do things better come from the bottom, and they come from the bottom with regularity and with clearness and conciseness of reason. Until you get accustomed to it, you will describe it as merely miraculous. Why? Because everyone is interested.

PROFIT SHARING IN ACTION

Before coming with the Council of Profit Sharing Industries, I asked the Board if I might tour some of the member companies. I was told I could go to any of them. I went alone, went in the plants, introduced myself, explained why I was there and walked around and talked. In one I talked to a foreman. He had been with his company for 28 years. He said, "You have never been in a profit sharing plant? Let me tell you. In about fifteen minutes there is a bell going to ring, not a loud bell, just a bell. I am going home. That fellow over there, he's a foreman and he is going home. This foreman, he's going home. From 4:00 o'clock this afternoon until 8:00 o'clock tomorrow morning there will not be one supervisor on the floor of this plant. Over the years that I have been here, I want to tell you that I have never failed to be amazed at 8:00 o'clock in the morning at how much work was done.

"Now let me show you. You see this battery of six machines. If you walk up close, you will see a brass plate on each one of them." I did. It gave the cost of the machine and read "This was purchased with money provided by those who own the shares of stock in our company. It was put here to help us do more and better work faster. It multiplies the abilities of all of us and it gives us a competitive position which pays all of our bills."

He told me that a short time before — this plant was a new one — he had come out to set up the machinery with a crew of men. He said there was a fellow there with a badge on, he was one of the contractor's men, and he came up and talked to me — he picked me out because he saw I was the boss — and I could see from his hands that he never had done an honest day's work. It wasn't long until I found out he wasn't a workman at all, he was an organizer. And he tells me he is going to organize this place and he is going to get more money for us, he is going to get us paid holidays, hospitalization, he is going to get us a pension, he is going to make things better. I said, "That is fine. How are you going to do this?" "Well, we are going to tell management we want it and if they don't give it, we are going to strike." I said, "You know, I got one brother and one brother-in-law and they work over in this steel mill in Gary, and over the years it seems to me I got one or both of those families moved in with me. So I know something about this business." And I said, "How much have you got? Are you in good standing?"

He pulls out a book and the book has got a lot of places in it for lots of stamps and lots of stamps in it. In the back there are places where stamps are not put in it. I look at it and I see blue ones, red ones, black ones and some are regular dues and some are strikers. I hand it back to him and say, "How much did it cost you to get this book?" He said, "Nothing. They gave it to me." I said, "How much do the stamps add up to?" Well, I had calculated this as I turned the pages, and he told me "A lot of money." I asked him how much and he didn't answer.

So I reached in my pocket and pulled out this book. This was the book showing his individual share in the profit sharing trust account of his company. He said, "That was just a year ago." That would be May 1957. So he turned the page and it was a little over $7,200 to the account of this foreman. He said he showed that to him and said, "Look, my friend, you go

now. You come back when you've got another kind of book."

COUNCIL OF PROFIT SHARING INDUSTRIES

Now a word, if I may, about the Council of Profit Sharing Industries. A group of men in this country who believed that goods and services could be produced in equity, in peace and in harmony, in cooperation — in contradiction to the draining conflict to which all of us have been subject — persuaded Senator Vanderburg of Michigan to organize an investigation into how it was that throughout the years of the desolate Thirties, there were some companies that were able to keep smoke in their smokestacks, and people working. It turned out to be an investigation into profit sharing. For the first time those people began to know of others in this country who felt in a like fashion.

They decided to form an organization. The war came along and it was postponed to immediately after the war. The purpose of the Council was to disseminate the knowledge of partnership, the knowledge of how to work together. We are anxious to help any firm with a study of profit sharing to decide whether or not it is for you.

Now our advice is as honest as we can make it. We reserve the right to investigate a concern and then to say, if those words are warranted, "We are sorry. Profit sharing does not appear to be for you." In that connection, the very distinguished and able preceding speaker's (Mr. Smedley) topic has some connection with this. We use the P/V diagrams in our method of investigation, and where we find a fellow whose loss is a great deal bigger than his profits, we tell him "Perhaps tomorrow."

We look forward to that day when we may all realize that the only way we can make bigger shares is to increase the diameter of the whole pie. There is no other way. That is the day when we will have achieved, I think, not social security, but social maturity. Thank you.

1960 Annual Conference Committee

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SECOND MIDWEST CONFERENCE

Friday, October 14, 1960

Plankinton House

Milwaukee, Wisconsin

Chapters Participating:
Calumet
Chicago
Detroit
Fox River Valley
Joliet-Kankakee
Kalamazoo
Milwaukee
Peoria
Skokie
Tri-Cities
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Eight Seminars, you chose two;

Lunch, Coffee Breaks;

Registration fee $10.00

Conference Chairman — Omar E. Junker

NATIONAL SOCIETY FOR BUSINESS BUDGETING

To: The Members of the National Society for Business Budgeting

From: Art Moor

Subject: Editorship of BUSINESS BUDGETING

At the Board of Directors Meeting in May, Larry Haverkamp submitted his resignation as Editor of BUSINESS BUDGETING. After serving the Society in this capacity for three years, additional responsibilities in the Trailmobile Company required giving up the editorial work. This decision was a great disappointment to his many N.S.B.B. friends throughout the country.

During the period he was Editor, the circulation of BUSINESS BUDGETING has almost doubled. As a result of his efforts, many improvements were made in the format, appearance and the content of the material published. He has done an outstanding job and his contribution in the future will be missed.

The new Editor is Neil Denen, Regional Director in Region III and last year's president of the Tri-Cities Chapter. We are fortunate to have someone in the Society with Neil's background and experience which eminently qualify him for this assignment.

BUSINESS BUDGETING is one of the most important contacts the Society has with our membership and the business world. To maintain the fine reputation the magazine has attained, Neil is going to need the support of the Board of Directors, the Chapters and the Membership. I am sure he can count on all of us.

Sincerely,

Art Moor

Art Moor

ADM:bn
9/1/60

ELEVENTH ANNUAL CONFERENCE — MAY 25-26, 1961 — STATLER HILTON, DALLAS